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Message Text

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ACTION ARA-14

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E.O. 11652: N/A
TAGS: EFIN, PE
SUBJECT: PERU'S FINANCIAL CRISIS ANALYSIS OF NEW AUSTERITY MEASURES

REF: (A) LIMA 4045, (B) LIMA 4077, (C) LIMA 4158

1. SUMMARY: THIS CABLE PROVIDES ANALYSIS OF ECONOMIC MEASURES ANNOUNCED BY GOP EVENING MAY 14; SEPTEL GIVES POLITICAL CONTEXT. NEW MEASURES ARE DESIGNED PRIMARILY TO CUT PUBLIC SECTOR EXPENDITURES AND COMPLEMENT REVENUE PRODUCING MEASURES ISSUED MAY 10(REFTELS A AND B). EARLIER ON MAY 13 GOP ALSO ANNOUNCED AUSTERITY MEASURES WITHIN ARMED FORCES, INCLUDING INTER ALIA REDUCTION IN FREE GASOLINE RATION, SUSPENSION OF AUTOMOBILE ACQUISITION, REDUCTION IN NUMBER OF ATTACHES ASSIGNED OVERSEAS, AND NUMBER OF TRIPS (DOMESTIC AND FOREIGN) AND DECORATIONS FOR ARMED FORCES PERSONNEL (IR 68760124).
OFFICIAL EXCHANGE RATE HAS BEEN ALLOWED TO MOVE (WITHIN GENTLEMEN'S AGREEMENT) TO 147/$ RANGE. OUR PRELIMINARY ANALYSIS (WHICH
CHECKS OUT WITH GOP AND PRIVATE SOURCES) INDICATES THAT NEW MEASURES WILL HAVE IMPACT IN 20-22 BILLION SOLES RANGE. WAGE INCREASE OF 1500 SOLES ANNOUNCED EVENING MAY 15.

2. ON EVENING OF MAY 14 THE GOP ANNOUNCED A SERIES OF DECREE LAWS, MINISTERIAL RESOLUTIONS, AND OTHER MEASURES WHICH ARE
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DESIGNED TO COMPLEMENT THE PRIMARILY FISCAL MEASURES THAT WERE ANNOUNCED MAY 10. THE MAJOR (AND POLITICALLY THE MOST SENSITITVE) MEASURES IN THIS SECOND ROUND INCLUDE (A) INCREASES IN PETROLEUM PRICES FROM 75 TO 125 SOLES PER GALLON OF 84 OCTANE GASOLINE AND FROM 110 TO 145 SOLES FOR 95 OCTANE, (B) PUBLIC TRANSPORTATION FARE HIKES, AND (C) PRICE INCREASES IN BASIC FOODSTUFFS, SUCH AS BREAD, FRESH AND CONDENSED MILK

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AND VEGETABLE OIL. REPRESENTATIVE SAMPLING OF PRICE INCREASES
FOLLOWS:

ITEM	OLD PRICE	NEW PRICE	PERCENT OF INCREASE
BREAD (40 GRAM ROLL)	1.50	2.20	46.7
SPAGHETTI (1 KG.)	46.50	69.50	49.5
COOKING OIL (VEG-1 LITER)	80	184	130
EVAPORATED MILK (14.5 OZ. CAN)	27.50	39	41.8
GASOLINE (GAL.84 OCTANE)	75	125	66.7
GASOLINE (GAL. 95 OCTANE)	110	145	31.8
COOKING GAS (24 LB. CYLINDER)	170	225	32.4
DOMESTIC KEROSENE	10	15	50
DIESEL 1 (GAL)	30	52	73.3
DIESEL 2 GAL)	29.50	50	69.5
MICROBUS	8	12	50
URBAN BUS (GOV. RUN)	10	14	40
STUDENT FARE	4	5	25

PART OF INCREASED PRICES FOR PETROLEUM PRICES IS INCREASE
IN TAXES ON THESE PRODUCTS.

3. ON MAY 13, PERUVIAN GOVERNMENT ANNOUNCED SUPREME DECREE NO.
006-78-CCFA WHICH INCLUDED A NEW SERIES OF AUSTERITY MEASURES FOR
MEMBERS OF THE ARMED FORCES. THESE MEASURES INCLUDE, INTER ALIA,
THE SUSPENSION OF THE PURCHASE OF AUTOMOBILES UNDER LIBERAL
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TERMS, A 20 PERCENT REDUCTION IN THE CURRENT FREE GASOLINE RATION,
REDUCTION IN THE NUMBER OF MILITARY ATTACHES ASSIGNED TO
PERUVIAN DIPLOMATIC MISSIONS ABROAD, LIMITING TO GREATEST
POSSIBLE EXTENT THE NUMBER OF MILITARY ASSIGNED TO STUDIES
ABROAD, LIMITING FOREIGN AND DOMESTIC MILITARY TRAVEL, AND
REDUCTION IN EXPENSES FOR SOCIAL FUNCTIONS AND DECORATIONS.
IT IS BELIEVED THESE MEASURES ARE MORE IMPORTANT FOR THEIR
PSYCHOLOGICAL IMPACT THAN FOR THEIR ECONOMIC EFFECT.

4. THE FISCAL IMPACT OF MAY 14 MEASURES ARISES FROM INCREASED
REVENUES FROM TAXES ON PETROLEUM PRODUCTS AND DECREASED
EXPENDITURES DUE TO REDUCTION FOODSTUFF SUBSIDIES. GOP BUREAUCRACY
CAUGHT BY SURPRISE BY ANNOUNCEMENT OF NEW MEASURES AND HENCE DOES
NOT HAVE CLEAR SET OF CALCULATIONS SHOWING THEIR EFFECT. CENTRAL
BANK OFFICIAL, WHO IS ALSO KEY ADVISER IN COAP STAFF, STATED
FISCAL REVENUE FOR REST OF 1978 FROM SPECIFIC PER GALLON TAXES ON
PETROLEUM PRODUCTS AT S/. 10,040 MILLION AND FISCAL REVNUES
FROM INCLUSION PETROLEUM PRODUCTS UNDER TURNOVER TAX AT S/.5,120
MILLION. HE ALSO STATED THAT PETROPERU'S NET REVENUES FROM NEW
MEASURES ARE ALSO INCREASED BY S/.9,568 MILLION FOR A TOTAL IMPACT
OF S/.24.8 BILLION. OUR INDEPENDENT CALCULATIONS
SHOW AN ESTIMATED S/ .27 BILLION IN TOTAL IMPACT -- THEY CONFIRM THE

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S/.10 BILLION IN FISCAL REVNUE FROM SPECIFIC PER GALLON TAXES ON
PETROLEUM PRODUCTS BUT SHOW SOMEWHAT HIGHER FIGURES ON REVENUE FROM T
THE
TURNOVER TAX AND NET NON-TAX REVENUE WHICH GOES DIRECTLY TO
PETROPERU.
ACCORDING TO UR CALCULATIONS INCREASED PRICES FOR BREAD, VEGETABLE
OIL, AND EVAPORTAED MILK ELIMINATE SUBSIDIES -- AT LEAST UNTIL
THE EXCHANGE RATE MOVES UP TO 180/$. A KNOWLEDGEABLE PRIVATE BANKER
CONCURS IN THIS ESTIMATE. ECONOMIC SUBSIDIES PROJECTED BY THE GOP IN
JANUARY FOR THESE PRODUCTS WERE S/. 11.4 BILLION; THEREFORE, ELIMINA-
TION AS OF MAY 15 IMPLIES A S/. 7.1 BILLION REDUCTION FOR THE
BALANCE OF THE YEAR.

5. CENTRAL BANK OFFICIAL ALSO NOTED THAT THE BANK HAD PREPARED ITS
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ESTIMATE ON GOP FISCAL OPERATIONS (REF B) ON BASIS OF GRADUAL
ELIMINATION OF FOODSTUFF SUBSIDIES, SO THAT NEW MEASURES WILL HAVE
MORE FAVORABLE IMPACT ON EXPENDITURES THAN 41 BILLION SOLES DEFICIT
REDUCTION ORGINALLY PROJECTED BY BANK. OVERALL IMPACT OF MAY 14
MEASURES IS IN 20-22 BILLION SOLES RANGE, AND, TAKEN TOGETHER WITH
MAY 10 REVENUE MEASURES, WHICH WILL BRING IN AN ESTIMATED 20-22
BILLION SOLES, WOULD TOTAL 40-44 BILLION SOLES REDUCTION IN
FISCAL DEFICIT. EXPENDITURE ELEMENTS OF EARLIER PROJECTION,
OBVIOUSLY,
DEPEND UPON WAGE PACKAGE,WHICH WAS ANNOUNCED EVENING MAY 15, AND
WHICH WE HAVE NOT YET HAD OPPORTUNITY TO EVALUATE. ACCORDING
TO FIRST REPORTS, WAGE RISE APPEARS TO 1500 SOLS ACROSS -THE-BOARD,
WHICH WOULD BE AN AVERAGE INCREASE OF PERHAPS 7-8 PERCENT FOR
WORKERS. EXCHANGE RATE MOVEMENTS WILL CONTINUE TO HAVE OFFSETTING
EFFECTS ON PUBLIC SECTOR EXPENDITURES AND REVNUES.

6. COPIES OF LATEST MEASURES BEING POUCHED ARA/AND/P - KEMP.
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